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RUEHIL/AMEMBASSY ISLAMABAD 1957
RUEHBUL/AMEMBASSY KABUL 1919
RUEHNE/AMEMBASSY NEW DELHI 1948
RHEHAAA/NSC WASHINGTON DC
RUEHKO/AMEMBASSY TOKYO 1586
RUEHVEN/USMISSION USOSCE 1871
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TAGS: EAGR ECON EAID ELAB PGOV PHUM TI
SUBJECT: THE FUTURE OF TAJIK COTTON - ANYTHING BUT LIGHT AND FLUFFY

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¶1. (U) Summary: Despite the ailing cotton sector's debt-ridden farms and declining harvest, cotton remains Tajikistan's most important export and biggest crop. International donors have joined forces, backing major projects to reinvigorate the sector. The Government of Tajikistan, the National Bank of Tajikistan, lending companies and international financial institutions are actively seeking cotton sector and land reform, united by an independent commission on cotton reform. The World Bank and Asian Development Bank December 13 sent a draft "Road Map" to the government to resolve the cotton debt through a series of reforms and technical assistance. U.S. assistance efforts complement the Road Map by focusing more broadly on the agricultural sector: promoting land reform will help build a viable land market, and developing the non-cotton agricultural sector will boost farmers' freedom to grow alternative products. While national attention is on cotton, the massive influx of income from foreign remittances to rural areas has softened the crisis by making the rural economy less dependent on cotton. End Summary.

Cotton Production

¶2. (U) Intense informal government pressure on farmers to increase output has failed to increase Tajik cotton production. As of November 20, farmers harvested 437,900 tons of raw cotton, about 80.1 percent of this year's national target of 547,000 tons.

¶3. Tajik Cotton Production, 2002-2006 (as of Dec 1; State Statistical Committee)

	2002	2003	2004	2005	2006
Area cropped (ha)	269,200	284,300	285,000		

288,000 250,000

Target (raw) 515,000 610,000 610,000
610,000 547,000

Production (raw) 515,500 537,400 558,000
547,000 440,000

¶4. (U) In 2006, the Government of Tajikistan allocated 250,000 hectares for cotton production out of 901,100 hectares of potential agricultural land. This cotton land target is 33,000 hectares lower than 2005, and actual land-use for cotton cultivation was likely lower than official statistics. In fact, annual "targets" were officially done away with several years ago, but district governments set Soviet-style unofficial local quotas, reporting progress almost daily during harvest season. Cotton cultivation reached its peak in 1991, before the collapse of the Soviet Union, when 298,800 of 821,000 hectares were used for cotton. From 1995-2006, Tajikistan ranked 14 in global cotton production, growing 0.6 percent of the world's cotton.

¶5. (U) According to the State Statistical Committee, exports of cotton fiber accounted for 9.5 percent of Tajikistan's exports from January-July 2006. Tajikistan exported 69,000 tons of cotton fiber for a total amount of USD 74.1 million over the first seven months of this year, which is 3,800 tons or USD 3.7 million less compared to the same period of 2005.

¶6. (U) The main trading partners for Tajik cotton-fiber exports are: Latvia - 23.8 percent; Iran - 20.8 percent; Kazakhstan - 19.3 percent; Uzbekistan - 12.4 percent; Ukraine - 3.6 percent; Turkey - 1.9 percent; Switzerland - 1.8 percent; and Slovakia - 1.4 percent.

¶7. (U) Downstream industries have suffered as well. Tajikistan's largest cotton oil production factory, located in the northern city of Kanibadam, formerly processed 125,000 tons

of cotton seeds each year but now sits idle. Despite limited successes in the textile industry, most Tajik cotton is exported in its raw form. Only 12-14 percent of cotton production goes to the domestic textile industry (Reftels A, C).

Explaining the Drop in Production
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¶8. (U) The halving of world cotton prices between 1995 and 2005 drastically reduced the profitability of the cotton sector in Tajikistan. Tajikistan's cotton farmers are the poorest in the world, taking home less than 25 percent of the market value of their product, while saddled with enormous debts from middlemen lending companies. The extremely uneven distribution of cotton profits, which benefits intermediary investors and exporters, undermines production incentives.

¶9. (U) Despite several international micro-lending projects to help small farmers, Tajik farmers still lack investment capital. The cotton sector suffers from old equipment, ill-defined land-use rights, and up to USD 300 million of controversial debt to "futurist" lending companies. With most farms facing crushing debt, Tajik banks provide loans only to sustain the production cycle, not for capital investment. According to the State Statistical Committee, 19,947 tractors operate in the agricultural sector. However, these tractors average 30 years in age and many have not been used for years. Based on capital depreciation of previously reported assets, we estimate upwards of 70 percent of these tractors are actually scrap-iron.

¶10. (U) Despite President Rahmonov's direct plea to foreign companies to invest in the cotton processing sector, outside investors struggle with corruption at every level of bureaucracy (Reftel A). A U.S. cotton processing company attempted to enter the Tajik market in 2000 but could not get through the layers of

local government bribery. However, a successful U.S.-based cotton processing company, Well Brothers, has well-developed contacts with Tajik partners in the "Rahsh" exporting company, a politically connected firm.

¶11. (U) Many cotton producing areas suffer from marked salinity due to poorly maintained irrigation and farm drainage systems. Despite the relatively high price farmers pay for farm inputs and seeds, the quality of these inputs is very low. Under Tajik law, no new seeds have been allowed in since 1992. Because the best cotton seeds go to oil, the seed stock gets worse each year. The state controls seed regulation, and no private or foreign companies are involved in cotton seed imports.

Two Major Problems: Land Reform and Cotton Debt
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¶12. (U) The incomplete structural and legal reform of the Soviet collective "kolkhoz" farms and state-owned "sovkhoz" farms continues to reduce the profitability of land. Following the signing of the "Law on Dekhan Farms" in March 1992 and the revision in April 2003, most kolkhozes and sovkhozes were simply renamed collective "dekhan" farms with no restructuring or distribution of ownership. Dekhan farms operate as either mini-cooperatives - worked and managed by a group of people; or as small privately-owned farms. In 1996, the land reform process was accelerated (but not in quality terms) by the introduction of Presidential Decree 522, which mandated all lands converted to dekhan holdings by 2005. According to the State Land Committee, 850 state farms existed before the land reforms, multiplying to 28,452 dekhan farms after the reforms, with 170 state farms left alone for the purposes of seed and livestock breeding. In June 2006, Decree 522 was cancelled and replaced by Decree 1775 "On additional measures on reorganization and reforming of agricultural organization," which did very little to further reorganize or reform farms.

¶13. (U) Sovkhozes and kolkhozes were separated into smaller dekhan farms but under strict and direct control of district

Hukumats (local authorities). In addition, these new farms inherited the debts of previous entities in direct proportion to the land they received. The so-called reforms created even heavier small farmer dependence on local authorities and futurist companies. Local farmers cannot easily switch from cotton to other crops due to the heavy financial debt burden and direct control by local authorities.

The Debt Cycle

¶14. (U) The cotton production model is very simple. The President announces the cotton plan, the National Bank regulates and provides appropriate credit to commercial banks: CreditInvest Bank (with the largest debt owner structure), and futurist companies (acting as operators for cotton finance and sales operations). Local Hukumats act as a local police force enforcing decrees on the dependent farmers. Although, de jure, farmers have freedom of choice of what to grow on their land, de facto, local Hukumats dictate how many hectares of land should be used for cotton. Farmers privately indicate they have freedom on only 20 - 30 percent of their land.

¶15. (U) One farmer's story illustrates the general plight. A farmer from Djilikul District near Qurghon-Teppa acquired 25 hectares of land to start a dekhan farm in 2006. This land came with cotton debts of USD 1,300 per hectare, owed to the futurist company "TAMER", and the farmer must pay 20 percent per year on this debt. At the beginning of the season, TAMER provides the farmer all inputs: including seeds, diesel, and fertilizer; and pre-pays his taxes. The farmer does not know how much he is paying for these goods until the end of the year, and TAMER does

not provide him a written contract. These goods inevitably cost the farmer more than market rates. At the end of the year, the farmer must provide all his cotton harvest to TAMER, which determines the cotton price only after the harvest.

¶16. (U) From 1992 to 1997, the Government of Tajikistan used AgroInvestBank (AIB), (under the direct control of the current chairman of the National Bank of Tajikistan Murodali Alimardonov and "Pakhtai Tojik," the government agency in charge of cotton), to finance the cotton sector. Due to an internal budget crisis in 1997, the government entered into partnership with the Swiss cotton trading company P. Reinhart, which provided USD 70 million for the cotton sector. In 2004, AIB passed about 80 percent of their financing and "debt" portfolio to the non-banking organization "Kredit Invest" (under Alimardonov's control). For the last five years, a number of financiers entered the market with funds sourced outside of the Reihard/AIB/Kredit Invest scheme, many from Russian cotton traders, banks and textile concerns. Futurist companies now face serious problems financing the future harvest. In 2005, Alimardonov managed to attract Kazakh banks and investment funds to help finance the Tajik cotton sector.

What the International Community is Doing About It
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¶17. (U) The Asian Development Bank announced on December 4 a USD 12 million loan and grant package to help restore productivity and profitability to the Tajik cotton industry. The project will help resolve the cotton debt through farm-by-farm analysis and policy reform measures. The project will implement the nation-wide adoption of the internationally recognized standards regime for cotton, the Universal Cotton Grade Standards, which will raise the value of Tajik-produced cotton.

¶18. (U) The World Bank is planning a USD 15 million "Cotton Sector Recovery and Poverty Reduction" loan project to help develop the cotton industry, with an emphasis on the processing sector. Per Rahmonov's personal request, the World Bank will provide a presidential advisor on cotton. The project will improve information flow up the supply chain, support

rehabilitation of irrigation, storehouses, and acquisition of farm machinery. In addition, the World Bank will provide political risk insurance to international investors through its Multilateral Investment Guarantee Agency as an enticement to invest in the cotton processing sector.

¶19. (U) Other donors are providing support as well. A Swedish development project will reform seed regulation and improve seed breeding. A British project will establish an arbitration system to support the debt resolution process. Canada provided some debt reform analysis.

¶20. (U) USAID is taking a broader approach to the agricultural sector. The USAID agricultural program targets both cotton and non-cotton food processing in order to provide farmers a viable alternative to growing cotton. By promoting the non-cotton sector, the U.S. has taken the advice of experts such as the International Crisis Group who warn about the dangers of the Central Asian "cotton monoculture." USAID's vital land reform project - which is developing legislation reform to enable an effective land market - targets both agricultural and non-agricultural land.

Debt Relief and Cotton Reform on Divergent Paths
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¶21. (U) Farm debt resolution remains an intransigent problem despite both Government of Tajikistan and international donor

efforts to address the issue. The Asian Development Bank and World Bank are each conducting studies to determine the actual size and makeup of the debt. The World Bank study covered only 14 farms and took over one year to complete, yet yielded little useful data; banks, futurist companies, and farmers have kept inconsistent and incomplete records of the debt histories. The ADB study should be complete early next year. Both institutions claim that the amount of actual debt is likely half of the USD 300 million claimed by the banks and futurist companies. Meanwhile, the government is waiting for the international community to come up with its "real" number for the debt and "resolve" it through donor debt forgiveness.

¶22. (U) Instead of debt forgiveness, the Asian Development Bank, World Bank and other donors drafted a Road Map to lead the sector to profitability to pay the debts itself. The stated goal of the Road Map is: "Resolution of the cotton debt crisis, and the establishment of policies and institutions conducive to improved economic returns for cotton farmers, processors, and financiers," by 2009. The Road Map connects government reforms with donor technical assistance on debt resolution, government interference, pricing and taxation, land reform, and rural finance. State Advisor to the President on Economic Policy Matlubkhon Davlatov will coordinate the negotiations of the Road Map on behalf of the government. Donors hope to finalize the agreement for the President's signature by February 2007.

¶23. (U) However, a fundamental gap exists between resolving the debt and increasing profitability of the sector. Cotton farmers will not be able to overcome their debts without some measure of debt relief, but the Road Map will not in itself alleviate the cotton debt. By agreeing to some form of the Road Map and pressing the government to implementing needed sector reforms, donors will have something concrete to tie to debt relief.

Cotton Important, But Remittances Support Rural Economy
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¶24. (U) According to the World Bank and the State Statistical Committee, the cotton sector supports 75 percent of the rural population in Tajikistan. However, this does not reflect current realities. While up to 550,000 people work in the overall agricultural sector in Tajikistan, up to one million work abroad as migrant laborers each year. Of these, roughly 800,000 come from rural areas. Remittances entering Tajikistan

through the banking sector in 2006 will reach well over USD 1 billion, of which an estimated USD 800 million will go to rural areas. Meanwhile, cotton production will provide a paltry USD 150 million, most of which benefits intermediaries and exporters - 25 percent going to farmers. Remittances provide USD 800 million to the rural economy, and cotton provides USD 40 million.

¶25. (U) As cotton becomes less profitable for individuals, more and more male farmers and seasonal workers migrate to Russia and Kazakhstan for better paying jobs, leaving women and children as the main workforce in the cotton fields (reftel B). Non-cotton agricultural productivity has jumped as rural families and farmers plant alternative crops for their own livelihoods and for the domestic and export market. By supporting farmers' freedom to make their own decisions, we will help balance out the domestic economy.

Future Prospects

¶26. (U) For the past 15 years, the government has made little progress laying the groundwork for an economically viable and transparent cotton sector. Farmers remain in financial servitude to local government and cotton investors, and have only vague ideas of how to manage their cotton operations and debts. Under current conditions, cotton production wastes

water, ruins land, employs children contrary to international law, and contributes to rather than alleviates poverty in Tajikistan. The existing cotton model benefits a limited circle of political officials and powerful investors. Meanwhile, everyone is waiting for someone to do something about the cotton debt.

¶27. (U) Lack of donor coordination weakened the Road Map even before its presentation to the government, with the World Bank failing to tie its major loan package to the Road Map. The World Bank also decided to leave out much of the land reform component, including a Unified Land Registry which it feels is too big a step to include in the Road Map. Other donors disagreed with the World Bank approach and feel that the Road Map does not provide sufficient incentive to the government to comply with its commitments. The Government of Tajikistan will face major obstacles to reform from local government officials who stand to lose control over the sector.

¶28. (U) The government and international community will likely agree to implement some version of the Road Map. Donor technical assistance will be crucial to developing the cotton sector and spreading its dividends broadly. Elites are divided, however, which will make reform slow-going. Farmers do not know where financing for the next season will come from, but most farmers will stick with cotton despite its low profitability. Cotton dominated Tajik agriculture for 80 years, and farmers have limited experience with alternative crops. Tajikistan's future may lie with cotton, but that future is far from certain.HUSHEK